Can a European Regional Market Assist Economies in Transition?

The following article by John Hardt, Senior Specialist in Soviet Economics at the U.S. Congressional Research Service, presents one side of a current debate; the article that follows, by the Hungarian economist Laszlo Csaba, presents another point of view.

To meet the goal of becoming open competitive economies, the Soviet Union and Eastern Europe should informally integrate within their region, concurrently with their integration into Western Europe and the global market economy.

However, preoccupied with the 1992 formal integration of the European Community (EC) — and feeling domestic pressure for protectionism — Western Europe is not doing enough to promote an all-Europe common market. Some European political leaders are resisting integration for the eastern region to prevent the perpetuation of the former Soviet-led trading system based on autarchy. Large segments of public opinion in Eastern Europe appear to share this concern. The countries of that region seem dedicated to a policy of maximizing contacts with the West and minimizing contacts with each other.

All-European Market — Wishful Thinking?

Although international integration is certainly a long-term goal, regional cooperation is extremely important now — to ease the process of market integration and mitigate the shocks resulting from a rapid transition to open markets. Such cooperation could be based on the all-European market model and should benefit from the support of Western nations and international organizations.

One possibility is a new regional market and cooperation arrangement, based on the Conference on Security and Cooperation in Europe, as suggested at the January 1990 CMEA meeting. While understandably there is an inclination to "kill CMEA and..."
dance on its grave," this sentiment may have long-term costs if no effective regional commercial organization replaces it.

The regional cooperation engendered by the post-World War II Marshall Plan is thought to have been a key contribution to Europe's economic growth. Would a new approach that accelerates the integration of competitive East European economies be feasible and beneficial?

Possible Arrangements

The following considerations are particularly important in planning a transition to a regional market:

- Currency convertibility is an appropriate and necessary goal. However, countries such as Poland, Czechoslovakia, Bulgaria, and Hungary could hardly carry the burden of price rises, for imported Soviet energy, and hard currency debt service simultaneously with economic adjustment. Regional cooperation may facilitate a more measured transition to convertibility. An East European payments union is not an appropriate remedy at this time, but some new mechanism may be indicated.

- Interregional consequences of large-scale industrial restructuring will require careful economic analysis. Precipitous closing of metallurgical enterprises, for example, the disruption of production, and the escalation of unemployment could affect the economy of the whole region. The highly centralized production of steel in Poland is dependent on the Soviet capacity to purchase the output.

- Agricultural reform depends not only on domestic factors, including privatization and farm-to-market system improvements, but also on access to foreign markets. A regional agricultural policy might be helpful in this regard and might also promote some degree of specialization. However, successful agricultural modernization would bring limited benefits in the face of Western Europe's restrictive common agricultural program. East European integration probably would require changes in the EC's agricultural policy.

- Infrastructure development and modernization of communications, transportation, and energy transmission can be more effectively pursued on a regional basis.

- Health, environment, and energy issues need to be coordinated within a regional and all-European framework. The Prime Minister of the Netherlands has proposed a European Energy Community to link the market-oriented states with the emerging democracies. Such an organization would integrate production, transportation, and energy use and would monitor energy resources. It would encourage regional development of oil and gas wells, advocate conservation, and fight environmental pollution. Both the Soviet Union and Eastern Europe need capital and technology to replace polluting coal and unsafe nuclear power plants with clean, safe energy production. Investment could come from an international concession system that would permit substantial control of the technical and management decisions by the Western partners.

- A new research and development facility could be set up to promote technology transfers to the region through international and bilateral institutions.

To sum up: the absence of regional cooperation runs counter to one of the major accomplishments—and lessons—of the Marshall Plan: development is fostered by successful regional market integration. Feasible remedies are complex, however, and currently do not command much support.

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### Eastern Europe Investment Climate — An Independent Assessment from the Private Sector *

(Individual country rankings)

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**Note:** 1 = Low risk 5 = High risk

* Source: Ernst & Young East European Division. February, 1991

Data were not derived from the World Bank, and the assessment is independent of the Bank's views.
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Is Regional Cooperation the Key?
Laszlo Csaba’s response

In his instructive article Can a European Regional Market Assist Economies in Transition?, John Hardt suggests more intensive regional cooperation among the reforming postsocialist countries as a pre-condition to their joining the global trade and payments system. He draws on the analogy of the Marshall Plan and the reconstruction of Western Europe, where systematic liberalization and regional integration indeed went hand in hand. He also deplores the obvious lack of enthusiasm among decisionmakers for regional cooperation.

More than nationalism

Is it just the notorious nationalism of the small nations in the region that hinders their espousal of this idea, or is there something more to it?

First, it is not clear whether Hardt’s suggestion extends to all European ex-Comecon members or to Eastern Europe in the conventional UN parlance — the three Central European states plus Bulgaria and Romania. After the Soviet Union’s “Pavlovian” currency confiscation measures and the introduction of decrees against “economic sabotage” — empowering the KGB to do whatever is necessary to counter what it sees as sabotage — there can be little commonality between Soviet economic change and change in postcommunist countries that are adopting the rule of law.

Second, the southeastern European countries, with their pervasive shortages and severe regulations, face qualitatively different systemic problems from those that beset the Central European states.

Third, there is relatively little trade between the countries of the region. For example, Romania is only Hungary’s fifteenth largest trading partner, and Bulgaria its twenty-third largest. The combined market share accounted for by Poland and Czechoslovakia in Hungary’s trade last year hardly reached 6 percent. (The share of intra-regional exports out of each country’s total exports in 1988 was: Bulgaria 18 percent, Czechoslovakia 30 percent, Hungary 17 percent, Poland 16 percent, and Romania 21 percent — ed.) This is not a surprise since geographic proximity has lost its relevance as a major determinant of trade.

New Marshall Plan?

Let us address the suggestion for an Eastern European Marshall Plan. Up to now, the volume of what has been written on helping postcommunist countries is in inverse relationship to the actual volume of capital inflow. Some experts suggest an amount of $20 billion to $25 billion as the minimum needed by Eastern Europe. This amount includes credits under normal commercial conditions; credit lines, which are a form of export promotion (and are used, according to two decades of experience, only 20 to 30 percent of the time in the best cases); and credit guarantees, which are used only when various other conditions are fulfilled. But in 1990, foreign direct investment was about $200 million in Poland, $500 million in Hungary, and only $800 million in the Soviet Union — when political enthusiasm for political transition was at its peak.

Beyond Eastern Europe’s obvious need for a major injection of Western capital, however, the analogy of the Marshall Plan remains debatable. Many serious arguments — including Hardt’s — favor emulating the Marshall Plan precedent, but there are various dissimilarities in the two eras that undermine the analogy.

• Liberalizing trade among Western European states in the late 1940s equaled liberalizing world trade at large. In contrast, the combined market share of the three Central European nations is below 1 percent of world trade at present.

• The issue for postwar Western Europe was the removal of wartime restrictions from economies where private property rights and free-market economic agents had always been dominant. Private property rights and
a middle class have yet to emerge in postcommunist countries.

- Although the previous point assumes a basic similarity in the economic order of contemporary Western nations, basic dissimilarities actually prevail, particularly among the Central European states. In Poland, for example, the zloty is internationally convertible for foreign direct investment, but non-residents faced problems repatriating money until recently. The Hungarian forint is not convertible, but nonresidents can buy whatever they want and can transfer, own, purchase, or sell against the forint as if it were a convertible currency. The Czechoslovak crown has become convertible as a consequence of a liberalized foreign trade regime, but conversion is permitted only for companies, not individuals, and only with restrictions. In sum, the three countries are examples of shock therapy, gradualism, and we-shall-see-ism, respectively.

- As a result of parallel industrialization, there are parallel shortages and overcapacities in the three countries. This implies that they need to be integrated into the European business environment before they can capitalize on the division of labor among themselves.

The cost of switching to convertible currency for trade with the Soviet Union is grossly overstated in the Central European states. Cost estimates are certainly misleading if one only considers the deteriorating terms of trade. People should not forget another problem that had been pervasive for many years and is being solved by the shift to convertible currency: how to refinance the huge ruble surpluses in trade and in the current account with the Soviet Union.

No doubt, the collapse of the Soviet economy does not allow the region to capitalize on the new flexible terms of payment. According to a mid-March report from the Soviet Bank for Foreign Economic Affairs, only $54 million in letters of credit has been issued to compensate Hungarian suppliers so far this year, whereas Hungarian firms have contracted for about $1 billion in exports to the USSR for 1991. Because commercial banks in Hungary charge 38 to 40 percent interest, with an inflation rate of 29 percent (1990), no company will be able to store its output for half a year or longer while waiting for the volatile situation in the Soviet Union to subside. This is the real shock for the Central European economies. Since only the current constrained barter arrangements remain for trade with the Soviet Union, the decline in bilateral trade will be greater than is economically justified.

However, it is hard to anticipate anyone financing either the transitory period of Soviet market consolidation or the radical readjustment that some major firms unexpectedly face. This might be the most serious challenge to the Central European democracies, due to the multiplier effect on employment and output and the fall-out in export earnings. Therefore, recession in the three countries will certainly be longer and inflation higher than early-1991 estimates forecast.

In my view, therefore, the speed and success of reorientation, privatization, and restructuring — rather than regional trade — are essential for systemic transformation in postcommunist Europe.


All things are possible

"It is quite clear that if the impossible becomes possible and the improbable probable, if world capitalism led by European capitalism establishes a new equilibrium ... and if capitalist production in the forthcoming years and decades begins to expand, we, the socialist state ... will have to try to catch the express train. To put it simply: ... it would have meant that we were wrong in our fundamental assessment of history. It would have meant that capitalism has not yet exhausted its historical 'mission' and that the present phase of imperialism does not represent its decline, its last gasp, but the birth of a new age of its progress." — Lev Trotsky, 1926.

Leveling the Playing Field for East European Exports

Over four decades, Eastern Europe and the Soviet Union were locked into an archaic trading system, a form of sophisticated barter, with prices negotiated by government officials and trade channeled through foreign trade organizations. A massive administrative superstructure — the Council for Mutual Economic Assistance (CMEA) — handled all negotiations and accounts.

With the end of the CMEA, prices will be determined by the international market, and payment will be in convertible currency. Enterprises may freely engage in foreign trade without administrative restriction. However, this abrupt switch in trade relations is causing severe impediments to intraregional trade. According to some predictions, overall intraregional trade, which declined some 30 percent in 1990, could drop another 30 percent in 1991. This could mean unnecessary loss of production and jobs far beyond what is required for economic restructuring.

The biggest challenge for Western governments and multinational organizations over the next decade will be to open Western markets to East European goods. An immediate challenge, however, is to ensure that trade within Central and Eastern Europe does not collapse over the next few years.

To stimulate intraregional trade, the West could help East European governments quickly establish export
credit facilities and could attract international commercial bank financing for these facilities by providing payment guarantees. Various export credit agencies already are providing $6 to $8 billion a year for Western exports to Eastern Europe and the Soviet Union. Without comparable financing for Eastern European exports, entrepreneurs in the region will have a difficult time winning orders — even if their products are competitive in price, quality, delivery, and service.

Western governments could furnish repayment guarantees for commercial bank financing of intraregional trade credits. The simplest approach would be for a multinational financial institution, such as the IMF or the new European Bank for Reconstruction and Development, to provide a special guarantee facility for East European export credit agencies.

This International Export Credit Guarantee Facility (IECGF) could be established without immediate outlays from Western governments, which would somehow incur contingent liability. A loan-loss reserve to cover potential claims would indicate to Western governments what their respective liabilities could be.

Loan-loss reserve funds should reflect the amount of the guarantees and the respective repayment risks. The size of the guarantees would depend on the level of intraregional trade in capital goods as well as the amount of competition between regional and Western suppliers — both of which would try to qualify for export credits from their government agencies. Regional trade in machinery and equipment is currently worth an estimated $20 billion a year at world market prices. Assuming that one-fifth of this trade will directly compete with Western suppliers who are backed by official export credit financing, the annual demand for guarantees would be $8 billion.

The IECGF’s repayment risk would arise only from the probability of default by both the East European borrowers (or their guarantors) and the East European export credit agency involved — which is unlikely. This reduces considerably the ultimate risk to the IECGF. Based on current perceptions of repayment risks in Eastern Europe and the Soviet Union — a reserve of one-tenth of the value of outstanding guarantees would appear adequate.

Annual demand of $4 billion would require an initial reserve of $400 million. Given that the average repayment period on these transactions would be about five to seven years, this means total reserves of less than $2 billion. (If an international finance institute were to create the IECGF, the institute could provide the reserves from its existing capital resources; this would avoid the necessity of direct outlays from the Western governments.)

The terms (level of coverage, period of repayment, cost, and security) of the export credits should be the same generous terms offered by Western nations to their own exporters. In addition, the IECGF should provide guarantees only for those transactions in which East European exporters are facing competition from outside the region backed by confirmed offers of official export financing. Such support should be offered for a limited time, after which the East European export credit agencies should be self-sufficient.

Western assistance in establishing export credit facilities to support intraregional trade will mitigate the loss of production and jobs in these economies during a difficult period of transition. It will also help the region move more quickly into the normal multilateral practice of world trade and finance. And it can be achieved at low cost to Western budgets.

As a problem of both economic theory and practical economic reconstruction, the transition from a command economy to a market economy is unprecedented. As such it presents an extraordinary laboratory for economists, international bankers, repentant ex-Marxists, and assorted capitalist carpetbaggers plying their trades — and the lab rats are real people, desperately hoping for something better than they had under communism.

... It is worth lingering for a moment on a nearly forgotten, half-century-old debate about “market socialism.” In the 1930s it began dawning on some smart socialists who had been “over into the future” that the future was not working all that well. The most notable proponent of this school was a cosmopolitan Pole, Oskar Lange, who worked at Harvard, Berkeley, Chicago, and London as well as Krakow before World War II, and at Warsaw for twenty years afterward. A socialist widely acquainted with the classics, an admirer of Schumpe ter as well as of Stalin, Lange hoped to reconcile neoclassical economics with Communist social ideals, as well as to achieve a politics of peaceful coexistence. This endeavor, it turned out, was like squaring the circle.

Lange set out to refute the claim of Ludwig von Mises, Friedrich Hayek, and Lionel Robbins that socialism was theoretically and practically unrealizable. Lange hoped that a large state sector could coexist with small private enterprises, whose pricing and market discipline would keep the state sector honest. This, in effect, was the inverse of the Western social-democratic idea of “yardstick competition,” in which public enterprises would serve as a check on private ones. He urged that state planners pay far more careful attention to prices as the crucial signaling devices necessary for an efficient allocation of resources.

A related question is which reforms can feasibly be accomplished with a big bang, and which ones must be done over time, ... The big bang solution, even for such basics as currency convertibility and price reform, has its limits. Political democracy in Poland, Hungary, and Czechoslovakia is still fragile, and it scarcely exists yet in Romania and Bulgaria. Governments brought to power on public expectations of economic as well as political liberalization are understandably reluctant to impose new austerities. Their double bind is excruciating. If they continue subsidizing ultimately uncompetitive industries, they only waste resources and defer a day of reckoning. On the other hand, if they instantly subject antiquated local industry to the full force of global competition, millions of workers are idled, the balance of payments worsens, and political stability is undermined.

... As a question of both economic philosophy and social engineering, the
most intriguing issue by far is how to structure economic ownership in post-Communist Central Europe. In principle, most property belonged to "the people"—indivisibly. Now, suddenly, shares are being divided up. But how? Each alternative has benefits and costs. One option is simply to auction off state property to the highest bidder, as Poland abortively attempted. The problem is that foreigners make off with the healthiest enterprises, and potentially salvageable state firms are shut down for lack of current buyers.

A second option is what is termed "spontaneous privatization": the existing managers and/or workers are given ownership of the firm. The trouble here is that it leads to an indefensible distribution of windfall prizes or hardships, and rewards malefactors of the ancient regime who happen to be in place as managers.

The richest and ultimately most promising approach is to realize something of the original promise of socialism—by privatizing in a manner that broadly distributes ownership. . . . All over the former Soviet bloc, teams of experts are conjuring up variations on this theme of broad private ownership. It is, in my view at least, the single most hopeful social invention that could emerge from the wreckage of communism.

Of course, thus far we have been treating the easiest cases—countries where relatively democratic and stable political regimes already exist and where a Lech Walesa or a Vaclav Havel retains enough prestige to make hard decisions that will cause temporary adversity. In Yugoslavia, the risk of political disintegration is overwhelming attempted economic reforms. . . .

The most puzzling special case is China. Although events in Eastern Europe and the Soviet Union have proved once and for all that "market Socialism" is an oxymoron, the Chinese have managed a series of ingenious reforms that have tolerated fairly sizable market institutions, and reaped economic benefits accordingly, while still remaining a totalitarian Communist state. Thus Chinese farmers are free, once they have met the state production quota, to produce whatever they can and sell it on the free market. Chinese entrepreneurs, operating Dickensian garment factories or electronics sweatshops with up to a hundred employees, can produce for world markets, in joint ventures with Western capital, and keep a big chunk of their profits. . . .

. . . And in the mother of totalitarian socialist republics, the moment of glasnost and perestroika has come—and gone. Compared with the USSR, Eastern Europe has it easy. Russia seems proof positive that political revolution must be completed before economic revolution can move forward. But political revolution has stalled. Four months ago, after a brief window of possibility, the Shatalin 500-day plan toward marketization and kindred radical reforms were shelved. Gorbachev's regime lacks the legitimacy to extract sacrifice on behalf of an emerging market economy, while it is also losing power to make the existing command economy heed its commands. Production is falling, in part because suppliers are refusing to deliver product for worthless rubles, and local commissars can no longer enforce compliance with the plan. As a result the economy is degenerating into a barter system. . . .

Communism has turned out to be a century-long detour from the nagging question that perplexed Marx and a great many non-Marxists as well: how to reconcile efficient production with a bearable society. Communism produced neither. The dilemma, however, persists, and the question now will be fought out on the terrain where it always belonged—among variations of a liberal, market society. The collapse of communism doesn't end the debate about the appropriate boundaries between state, market, and civil society, any more than it ended History. . . . The complex task of domest icating market society remains. The third way, however, is not reform Communism but reform capitalism.

From a recent article "Eastern Europe's Great Transformation — the Dustbin of Economics," in The New Republic. The author is economic editor of the weekly magazine.

The World Bank estimates that the rural population living in absolute poverty fell almost continuously during the decade, from 272 million people in 1978 (33.5 percent of total rural population) to 66 million in 1989 (7.3 percent of the total). Most of the progress occurred in the early 1980s when agricultural growth was most dramatic; rural poverty has been falling more slowly since 1985 (when it had already declined to about 9.8 percent of total rural population).

Who are the poor?

Absolute poverty in China has increasingly been reduced to a hard core that comprises two main groups: individual households that suffer temporary or permanent hardship—even some that are in comparatively affluent areas—and inhabitants of critically disadvantaged regions with a poor natural resource base for pri-
mary production. The latter suffer further because of their isolation and underdeveloped communications systems. Such areas are found mainly in China's arid northwest, in the mountainous southwest, and in pockets of the northeast.

Fifteen provinces in these disadvantaged regions (half of China's provinces, containing half the rural population) account for an estimated 80 percent of the absolute poverty in the country. The rural poor increasingly are concentrated among hillsides and mountains that are characterized as ecologically fragile — in many countries, migration has largely emptied such inhospitable environments of human habitation. But in China official policy has been averse to large-scale, long-distance transmigration.

Prior to 1978, the plight of the poor areas was exacerbated by emphasis on local self-sufficiency in basic foods — even in areas highly unsuitable for food production. This contributed to further degradation of the ecosystem. In acute cases, food transfers were necessary to stave off severe malnutrition in the population.

The growth sectors

In their search for solutions to poverty, policymakers have clearly shown a preference for assisting the poor to obtain productive employment rather than rely on welfare transfers. This principle underscores the importance of looking toward the main sectors of the economy for alleviating poverty because of their potential as sources of income and employment growth.

State enterprises' share of industrial output declined steadily in the 1980s. The sector's contribution to employment growth and poverty reduction is likely to stay modest even if reform accelerates significantly. The same is generally true for agriculture — many Chinese specialists believe that a third of agricultural workers could be eliminated with little effect on output.

Whether in terms of output, employment, or exports, the most dynamic element in China's economy in the 1980s was the nonstate industry and services sector, which includes construction, commerce, and transport. The nonstate sector has grown in both urban and rural areas. In the cities, the labor force comes from the so-called "floating population" — the millions who have flowed to the great cities to seek work in construction, marketing, repair, and domestic service. Their right to residence (or to benefit from social services) is precarious, and authorities encourage many of them to return to their places of origin. (The 1990 census recorded some 30 million people living away from their officially registered residence for more than a year but did not attempt to count the short-term floating population.)

Until the 1989 credit squeeze, nonstate, nonagricultural enterprises in rural areas experienced virtually uninterrupted growth. (These "administratively rural" areas may include densely populated suburbs extending to city lines and may also encompass some fairly substantial provincial towns.) The share of the so-called township and village enterprises in overall industrial output expanded from 8.7 percent in 1978 to 26.2 percent in 1989; their share in exports rose from 3.9 percent in 1985 to about 20 percent in 1989. The sector's growth in services has also been rapid. Employment data are more difficult to compare across time due to changes in coverage (especially of part-time and seasonal workers), but in the late 1980s about 10 million new jobs were created annually. The number of workers employed for at least three months a year in rural industry and services exceeded 90 million by 1988-89.

Human capital

Nonstate enterprise growth and development must be an important part of future anti-poverty policy. Specifically, priorities include:

• holding down local taxes and other financial demands, and providing support for the new private enterprises that are emerging alongside the more traditional local-government-owned firms;
• achieving greater flexibility in financing these enterprises. Although

Reform and the New Five-Year Plan

In a recent address to the National People's Congress, Premier Li Peng asserted that the country must nurture foreign trade and maintain the "open door policy" introduced in 1978. He said there was no going back on "combining a planned economy with market regulation." Li promised legislation to improve the investment climate and open up the country to more foreign technology. He warned that China's budget deficit, which hit $2.9 billion in 1990, could threaten political stability.

Meanwhile, the National People's Congress is set to approve the 1991-95 five-year plan, which is a broad endorsement of further reform. The reformist impulse is evident in the following features of the plan:

• reduction of the number of commodities subject to government allocation and price setting; encouragement of enterprise contracting and autonomy in areas not specifically restricted by

the central plan; continuation of a coastal development strategy; further encouragement of foreign investment and rural industrial development;

• use of the market to guide small-scale investment and enterprise operations;

• less emphasis on heavy industry and more on a balanced strategy.

An annual real GNP growth rate of 6 percent has been targeted. Priority is on energy, transportation, infrastructure, electronics, and some crucial consumer goods. Agricultural policies have been tightened. Emphasis on grain production may retard development of animal husbandry and a more diversified farm economy, however. Furthermore, gradual abolition of dual-track prices — low state-set prices and higher market prices for a single commodity — could imply an extension of fixed prices in some cases.

From the Oxford Analytica, London
recent programs have encouraged state banks to step up lending in poor areas, much of this activity has actually been directed to large, often inefficient, county government enterprises. The newly emerging private banking sector is more attuned to financing nonstate firms, but the issues of how and by whom prudential regulation should be exercised have not been settled.

• Promoting human capital formation in the poorest areas. Although most provinces are close to the goal of universal primary education, it is increasingly clear that the more sophisticated rural industries expect their prospective employees to have a junior secondary school education. Young people who complete junior secondary school will have a better chance in competing for jobs, not only in their home counties or for the relatively menial positions available to the urban “floating population,” but also in booming private sector industrial employment, for example in the coastal regions such as Guangdong and southern Zhejiang. However, inducing qualified teachers to work in backward rural areas is a major challenge. Experimenting with short-term, voluntary assignments and incorporating generous financial inducements would be desirable.

Debate on migration

The potential benefits and consequences of internal migration — primarily to seek jobs — must be considered. Development within poor regions is constrained by their limited resource base and their remoteness from both internal and external markets. However, many parts of the Chinese labor market — including state enterprises and many local government-owned firms — remain largely closed to migrants.

Official attitudes about the recent acceleration of internal migration are ambivalent. Some local authorities in labor-surplus regions see merit in temporarily exporting labor. This can alleviate population pressure on the land, endow migrants with new business skills, and generate remittances for families left behind. The Chinese are starting to develop institutional structures, such as fixed-term labor contracts, to make labor exporting more stable.

In potential host areas, interest is divided. Employers stand to benefit from lower-cost recruits, but established urban workers fear the new competition. Local governments, already under fiscal pressure, may understandably resist extending costly services and social programs to newcomers.

Building consensus about these new dilemmas of reform will not be easy, but the challenge cannot be postponed indefinitely.

Anthony Ody
World Bank, AS3CO

Milestones of Transition

Hungary has adopted a four-year economic program for speedy privatization of the economy. Competitive interest rates to encourage savings and complete import liberalization should be achieved in 1992. By 1993, Hungarians will be allowed to hold foreign currency without restriction and arrange for hard currency credits without authorization from banking authorities. The forint could be fully convertible and introduced on international exchange markets by 1994, according to Finance Minister Mihaly Kupa.

European Community finance ministers have approved a loan to Bulgaria worth about $390 million, on condition that the other members of the Group of 24 match that amount. To qualify for the loan, Bulgarians negotiated a standby agreement with the IMF on its economic program (see page 13).

The country must still negotiate a rescheduling of Paris Club debt and agree with its commercial lenders on interim deferral of debt servicing. The EC commission has been invited to present similar proposals for Romania in April.

Romania recently received a bridge loan of $300 million through the Bank for International Settlements. This marks Romania’s return to the international credit market after a 10-year break, National Bank governor Mugur Isarescu announced. He hopes that Romania will qualify for about $2 billion in foreign capital from international banks and through direct investments in 1991.

According to the Oxford Analytica, Romania’s industrial production last year slumped to 84.9 percent of its 1989 level. Electricity generation is down by 25 percent, and factories remain idle as fuel supplies from the Soviet Union fail to arrive. Hard currency reserves ($1.4 billion last year) were wiped out in a spending spree before the May 1990 elections. Inflation is estimated at 30 percent per month. Approximately 200,000 people are unemployed, and the figure may rise to more than 1.6 million (8 percent of the work force) by the end of this year. The balance of payments showed a deficit of 1.5 billion dollars in 1990 and could reach 1.7 billion dollars soon.

The Romanian government has introduced various economic reforms. A legislatived package allows foreign investment in almost any economic sector. Controls on repatriation of profits have been lifted. Large industrial plants will be privatized through distribution of shares to every citizen. In the first stage people will receive entitlement certificates to be converted to

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Milestones (continued)

shares in any company of their choice. The shares would have to be held for at least two years.

Lack of agreement on property rights has been an obstacle to economic recovery for the eastern part of Germany. Recently, the Bonn government agreed that property confiscated by communist governments should be transferred to entrepreneurs who are willing to provide jobs. Firms and parcels of land will be sold to investors until the end of 1992 — even against the will of the original owners if the sales are deemed likely to create or safeguard jobs or to improve the country’s competitiveness. Treuhandanstalt, the agency in charge of privatizing former state-owned firms in eastern Germany, is restructuring companies that are not yet ready for privatization at a cost of several billion DM per year. The agency is clearing the way for new construction projects in eastern Germany with major land sales over the next three months. Sale of 1,000 parcels of land to private investors could raise DM25 billion and could stimulate eastern Germany’s construction industry.

The GNP of eastern Germany shrank by a real 20 percent last year, according to estimates. Output collapsed, mainly in the third quarter, when the deutschmark was introduced. Although economic conditions have stabilized, a further GNP contraction is likely this year. Bundesbank Director Hans Tietmeyer said the economic slump in eastern Germany would be deep, as economic problems facing the region had been underestimated. He cited the near disappearance of eastern Germany’s export markets, domestic markets shunning local goods in favor of Western ones, setting up an administration, and uncertainties over property rights.

On March 15, Paris Club creditors agreed to write off about half of the $33 billion they are owed by Poland, reducing for the first time the official debt of a middle-income country. Paris Club creditors expect Poland’s commercial creditors to provide comparable arrangements for the country’s commercial debt. Poland would receive a $5.8 billion cut in its estimated $11.5 billion bank debt and overdue interest payments if commercial bankers matched cuts made by creditor governments. The United States would cut Poland’s $2.9 billion official debt commitment by 70 percent — beyond the 50 percent reduction by the Paris Club — over a period of years and would incorporate some “debt-for-nature” components.

SovietUnion President Mikhail Gorbachev has ordered an average 250 percent price increase starting April 2. The price of bread, which had not gone up for nearly 30 years, is set to triple, and the prices of hundreds of other staple foods and consumer products will rise as the government cuts subsidies affecting 80 percent of production. To soften the blow, wage earners will get a monthly raise of 60 rubles (the average wage is about 270 rubles in state enterprises). Savings accounts will have their value increased by 40 percent. Most of the new savings have been frozen until 1994, however.

President Jacques Attali of the European Bank for Reconstruction and Development said that the Soviet Union must persist with reform to receive EBRD assistance — specifically, macroeconomic stabilization, price liberalization, and property reform. Attali cited three priority areas of Western support for the Soviet Union: technical assistance for the legal system, infrastructure development, and help for the private sector from Western business.

Angola’s Finance Minister Aguinaldo Jaime recently announced a 50 percent devaluation of the kwanza to 60 per US dollar. (The Angolan currency trades on the parallel market for 800-900 per dollar.) This is the first major economic reform in Angola since the introduction of central planning 16 years ago. Further devaluations are expected. Service payments on the country’s external debt, estimated at $6.5 to 7 billion, are in arrears.

Some 300 of the 4,500 state industrial companies in Czechoslovakia are to be sold this year. The value of state enterprises is estimated at 200 billion DM, Tomas Jezek, the minister responsible for privatization in the Czech republic, said in a recent interview. Small-scale privatization is going ahead; 300 businesses have been sold at auction. Part of the proceeds will be used to compensate workers affected by privatization and liquidation of enterprises.

Yugoslavia is seeking to reschedule payment on its $840 million overdue debt. The federal government announced on March 26 that it has asked the Paris Club to postpone repayment for an indefinite period. Vice governor of the central bank, Zarko Trbojevic, had already indicated that Yugoslavia may face problems making scheduled repayments on its $16 billion foreign debt. The flow of hard currency into the country has slowed, and hard currency reserves have dropped to $5 billion from $10 billion. Yugoslavia’s principal and interest payments should be $4.3 billion this year, but industrial output is falling and exports are unsatisfactory, which puts a sizable burden on currency earnings, Trbojevic asserted. At present, negotiations with the IMF for fresh credit are in abeyance.
Valentine M. Moghadam  
**GENDER AND RESTRUCTURING: PERESTROIKA, THE 1989 REVOLUTIONS, AND WOMEN**  

Perestroika and democratization in Eastern Europe are having adverse consequences for women's employment and political participation. Culture and ideology are pressuring women to retreat into domesticity, with women in several countries being encouraged to leave the labor market. Women from eastern Germany face discriminatory employment patterns in the united Germany where, for example, social security schemes do not cover part-time workers. In the Soviet Union, glasnost is allowing Soviet citizens to voice formerly-banned prejudices against women's rights.

The author suggests further research, specifically on women's chances in the new labor markets, the changes in their employment rates, their income and benefits, the shift from secular to religious schooling and how it affects gender role socialization, and the fate of former social policies designed for women.

Further information: WIDER Publications, World Institute for Development Economics Research, Annankatu 42C, SF-00100 Helsinki, Finland. Tel:893-841.

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Bela Balassa  
**ECONOMIC INTEGRATION IN EASTERN EUROPE**  

As a response to the Marshall Plan, in 1948 the Soviet Union organized its own trading block, the Council for Mutual Economic Assistance (CMEA), with Bulgaria, Czechoslovakia, Hungary, Poland, and Romania the initial members. Unlike the Marshall Plan, the CMEA provided no financial assistance to member countries. However, the smaller CMEA countries received Soviet energy and raw materials at low prices in exchange for their — often poor quality — manufactured goods. In the straight-jacket of central planning these gains were more than offset, however. Centralized decisionmaking, lack of market price signals, and the annual forced balancing of exports and imports among countries resulted in economic and technological backwardness and a low level of trade.

Dissolving the CMEA seems appropriate now, considering the differences in the extent and speed of reform in the region. Some observers propose a temporary payments arrangement among the former CMEA countries, but these countries should strive for convertibility instead, argues the author.

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Branko Milanovic  
**POVERTY IN POLAND, 1978-88**  

Average income for Polish workers fell about 20 percent from 1978 to 1988; the ten years of economic crisis saw the ratio of those living below the poverty line increase by 10 percentage points. (Out of the 7 million estimated poor in Poland, 3.1 million are the "new poor.") Before the crisis, most of the poor lived in rural areas; now 70 percent of them are in cities. Poverty spread particularly among workers in the socialized sector — as their real wages sharply declined — and the real income of pensioners' households decreased almost as much as that of the workers.

Farmers and mixed households weathered the crisis better since they are more flexible in making economic decisions. Farmers could change the composition of their crops, and mixed households could vary their labor inputs between work in socialized industry and in private agriculture.

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John Nellis  
**IMPROVING THE PERFORMANCE OF SOVIET ENTERPRISES**  

Productive capacity in the USSR is overwhelmingly the property of the state. About 47,000 state enterprises operate in the industrial arena alone — adding energy, infrastructure, and large service-oriented firms might expand the number beyond 55,000. Changes during the last five years have not been sufficient to bring about large and sustained improvements in enterprise performance. Announced reforms do not empower enterprises to set prices, select inputs, locate plants, hire and fire their work force, or vary product lines according to cost and demand. The promised "level playing field" is far from established. Cooperatives, for example, pay higher prices than state enterprises for many inputs as well as much higher taxes on corporate profits.

The private and quasi-private sectors may expand rapidly, but it is inevitable that the Soviet state will — temporarily or indefinitely — control many firms.
What can be done short of ownership change to improve companies' performance? The author's ready answer: all state enterprises should be transformed immediately into joint stock companies and run as a profit-maximizing, commercial operations. In conjunction with price liberalization, a hard budget constraint should be imposed on all enterprises.

Most Soviet enterprises have long been burdened with noneconomic goals — including education for their workers and nearby residents — and forced to sell "socially desirable" products at less than cost. In the future the assignment of such objectives to firms must be minimized.

Enterprise management should have the power to set output prices, hire and fire, and to determine product line and quantity, and plant location. The role and powers of the branch ministries would be greatly reduced. Large numbers of middle and lower level managers need training by Western firms.

Simon Commander and Fabrizio Coricelli
PRICE-WAGE DYNAMICS AND THE TRANSMISSION OF INFLATION — EMPIRICAL MODELS FOR HUNGARY AND POLAND

Using a simple model, the authors analyze the transmission and short-run dynamics of inflation in the partially-reformed socialist economies after 1982. The model incorporates features derived from market economies where there are few producers and sticky prices, but it also captures attributes of the socialist economies, including chronic excess demand.

Estimating dynamic price and wage models and exploring the role and weight of foreign prices and domestic factors in stimulating inflation in Hungary and Poland, the authors find that domestic cost development is crucial in relating exogenous price adjustments to increases in inflation. Polish planners failed to address macroeconomic imbalances with price adjustments, but according to the Hungarian experience, administered prices can in some ways stabilize the system. The authors conclude that nominal anchors, particularly wage restraints, must be part of stabilization programs for reforming economies in the absence of effective market restraints.

Andrew Solimano
INFLATION AND GROWTH IN THE TRANSITION FROM SOCIALISM: THE CASE OF BULGARIA

The author discusses the nature of macroeconomic imbalances in Bulgaria and the impact of reform on inflation and growth. The paper looks at inflation from the demand and the cost side. In terms of demand, the author analyzes the impact of large fiscal deficits and changes in the money velocity on the inflation rate. If most prices are deregulated in the transition from central planning, fiscal deficits should be reduced to achieve a low inflation equilibrium. A numerical simulation is constructed to show that the transition may entail substantial inflation even if the process of reducing fiscal deficits has already started — the driving force being an increase in money velocity.

On the cost side, the paper sets up a simple model of inflation using Bulgarian data as parameters. This model examines the inflationary impact of currency devaluation and price increases for CMEA imports.

The paper points out that the supply response to the reform process is hampered by several factors: lack of well-defined rules for public enterprises, uncompetitive market structures, poor infrastructure, and obsolete capital stock. Adequate external finance is a key complement to the reform process to support output response and social sustainability.
IBRD IMF Supports Nicaragua's Economic Program

Representatives from the World Bank, the IMF, four other international organizations, and 15 countries recently indicated that they would provide substantial financial assistance to Nicaragua if the country clears its arrears of $360 million on previous loans. The announcement came at the end of a two-day donors' meeting at World Bank headquarters in March. The World Bank would prepare an "economic recovery credit to support an economic-restructuring program once Nicaragua clears its arrears with the Bank. Sector-based lending could start in agriculture, education, health, and nutrition, followed by project lending in infrastructure and the environment. President Violeta Chamorro's government announced an 400 percent devaluation of the gold cordoba (five to the U.S. dollar) as part of the effort to control hyperinflation and tackle fundamental economic problems. Other actions include tax reform and reducing government spending. Wages for the country's state workers would triple, and the government would guarantee the price of basic goods (rice, beans, sugar, and fuel). The IMF has said that Nicaragua's economic stabilization plans were "technically consistent."

Conable on Soviet Membership

Outgoing World Bank President Barber Conable reiterated that the Bank expects and would welcome an application for membership from the Soviet Union. "We would like the Soviet point of view and experience included in our deliberations," Conable is quoted as saying at a March 21 news conference in Copenhagen.

The World Bank's lending in Eastern Europe is about $3 billion a year now, compared with some $130 million two years ago. It will probably rise further since Bulgaria has just become a World Bank member and Romania wants to reinstate its lending program. Conable indicated that key requirements include a new work ethic and the development of a financial sector to serve private business.

IMF loan to Romania

The IMF Board approved a loan of about $295 million to Romania on March 15 to help the country meet the increased costs of oil and gas imports. Romania can draw the money from the Fund's compensatory and contingency finance facility during the current fiscal year. Domestic oil production has been declining since 1976. In the past, 80 percent of the imports came from the Middle East, the rest from the Soviet Union, paid for in transferable rubles. Now Romania has to make all payments for its oil and gas imports in convertible currencies. (The country joined the Fund in 1972 and as the Ceausescu regime repaid all foreign debts, the country had no outstanding financial obligations to the IMF.) In another development, Romania received a $10 million World Bank emergency loan to prevent its telecommunications system from collapsing.

Stand-by to Bulgaria

To support Bulgaria's economic reforms, on March 15 the IMF approved a stand-by credit of about $394 million to be drawn over the next 12 months. An additional $109 million in contingency financing might be made available if oil and gas prices increase more than anticipated and the balance of payments deteriorates. In February the Fund approved about $85 million from the compensatory and contingency finance facility and will provide an additional $46 million if energy prices soar further. Assuming full utilization of these amounts, the IMF's disbursement to Bulgaria would total about $654 million in the next 12 months.

Camdessus Sees $5 billion in East Europe Loans in 1991

The IMF's Camdessus said the Fund expects to lend Eastern Europe up to $5 billion this year and will probably provide substantial funding for many years. In a speech to the Council on Foreign Relations in New York on March 20, Camdessus said he expects IMF loans to act as a catalyst for an additional $15 billion needed from other sources. He acknowledged that output fell substantially last year in Eastern Europe, largely due to temporary factors such as uncertainty about reforms. Inflation has remained high, even though the region has adopted tough economic policies, and structural reforms, such as privatization of state-owned companies, have been slow. The daunting challenges ahead can be met, provided the countries persevere with reform and receive sufficient support from the international community.

World Bank Loan to Shanghai's Industry

On February 1, the World Bank approved a $150 million loan to China to reorganize industry in Shanghai. The $319.6 million project is planned for completion in 1996. It will be implemented by the Shanghai Municipal Bureau of Finance and will focus on restructuring and upgrading the production of electronic components, precision instruments, electrical apparatus, and printing machinery. The World Bank will provide financial, technical, and institution-development assistance, including training, computer hardware and software, and management consulting services.

IDA Assists Chinese Research

China will increase its scientists and other highly skilled professionals and equip laboratories with modern instruments through a scientific training and research project. The International Development Association (IDA), the World Bank affiliate that lends on concessional terms, is supporting the Key Studies Development Project with credit of $131.2 million. Other money will come from the Chinese government ($105.8 million) and UNDP (1.6 million). Under the project, the Foreign Investment Loan Office and the State Education Com-

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Agenda (continued)

mission will set up a national education and computer center at Zhongguancun and Beijing, and will install a communication system to link the computer center to research institutes and universities. The project will also include setting up new laboratories, expanding old ones, and launching a pilot laboratory management program.

China May Use ECO

According to a report in Japan's *Nikkei Kinyu Shim bun* on March 13, China is willing to use the World Bank's Expanded Cofinancing Operations (ECO) program. A Bank official said, "China is interested in raising funds not only by borrowing money from Western banks but also by issuing bonds in the markets." Several projects, including power plants, transportation, and chemical plants, were mentioned as possible bond placement operations that could be supported through the ECO program, the Japanese newspaper reported.

New IFC Missions in Eastern Europe

As of March 1, the International Finance Corporation (IFC), the private sector development arm of the World Bank, has resident offices in Budapest and Prague. (An IFC field office is already operating in Warsaw.) The new offices will support such IFC activities as direct investments, corporate finance services in the private sector, and development of capital markets and the commercial banking systems.

Head of the Budapest office:
Mr. Dennis Koromzay,
Budapest, 1054, Vadasz u. 31, 2. em.
Tel: (361) 131-3520;
fax: (361) 131 3714.

Head of the Prague office:
Mr. Vikas Thapa,
Siroka 5, Prague 1.
Tel: (422) 232-9430;
fax: (422) 232-5533.

Spotlight on Vietnam

During a UNIDO-sponsored investment forum in mid-March, Vietnamese and foreign companies signed 49 letters of intent and finalized one contract. About 100 joint ventures are still under consideration. Projects range from a curtain-lace factory to an aluminum plant and power station. Vietnam issued licences for 11 foreign business ventures worth $50 million. According to the head of Vietnam's Communist Party, Nguyen Van Linh, the country will pursue economic change while "avoiding the kind of instability sparked by such reforms in other countries."

Vietnam's leadership is hoping that foreign investment will one of the principal means of rescue from the deepening economic crisis — precipitated by the downgrading of economic and trade relations with the Soviet Union. The latter is insisting that all its commodity exports to Vietnam, such as oil, steel, cotton, and fertilizer, be paid for in hard currency at world market prices. Concern about how Vietnam will pay for its commodity imports has sparked price rises and inflation, expected to reach 300 percent this year. It has also led to renewed currency speculation. At this time last year, the dong had stabilized at 4,000 to the dollar; it has now fallen to about 8,000.

Actual investment has remained limited, despite the existence of a liberal foreign investment law since December 1987. Most foreign investment in Vietnam is for small-scale projects to improve communications and exploit the potential for tourism. The only large projects involve oil exploitation contracts with various Western European companies.

Based on Oxford Analytics, London

Evolution of the ideology — 1991

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From the Hungarian weekly Tallozo
Conference Diary

Public versus Private Enterprises
April 4-5, 1991 Liège, Belgium

International conference presented by CIRIEC (Centre International de Recherches et d’Information sur l’Economie Publique Sociale et Coopérative). Three working groups will discuss privatization issues, performance measures and comparisons, and incentive schemes and mixed markets.

Perestroika: Where Did It Go Wrong? What Can Be Done Now?
April 12-14, 1991, Croton, NY


Information: Judith Mehrmann, Russian Research Center, Harvard University. Tel: (617) 495-3800, fax: (617) 495 8319.

Sixth Annual Soviet and East European Business Prospects Conference


Annual World Bank Conference on Development Economics

Organized by the World Bank/PRE. Topics include: The Transformation Process in the Socialist Economies. Military Expenditures and Development. Role of Governance in Development. Urbanization. Papers have been invited from Jeffrey Sachs (Harvard University), Jan Vanus (PlanEcon), and Anders Aslund (Stockholm School of Economics). Conference for IMF/Bank Group staff, scholars, researchers, and policymakers from developed and developing countries.

Housing Policy Reforms in Eastern Europe
May 6-9, Prague, Czechoslovakia

High-level housing policy seminar organized by the Economic Development Institute and the EMENA Technical Department of the World Bank, and the Faculty of Law, Prague University; co-sponsored by the French Gaisse des Depots et Consignations, Paris. About 30 government ministers, high-level officials, and senior civil servants from Bulgaria, Czechoslovakia, Romania, Hungary, Poland, and Yugoslavia will attend.

The Baltic: Gateway to the Soviet Union?
May 10-13, 1991, Middlebury, Vermont

Seminar will discuss the Baltic’s role as bridge between the Soviet Union and its foreign investors and trading partners. Among the 40 guests will be the prime ministers of Estonia and Latvia, Georgia’s president, and the vice president of the Russian Republic.

Information: George Bellerose, Director, Geonomics Institute, 14 Hillcrest Avenue, Middlebury, VT 05753. Tel: (802) 388-9619.

Econometrics of Short and Unreliable Time Series—Model Building of Economic Transition in Eastern Europe
June 14-16, 1991, Vienna, Austria

International Conference at the Institute of Advanced Studies to discuss problems and constraints in "empirical studies under the non-standard conditions of serious deficiencies of the available data basis." Topics include: pitfalls of traditional econometrics in short and unreliable time series; current state of econometrics and statistics concerning model building, estimation and forecasting dealing with short and unreliable time series; and current efforts to model and forecast the economic transition in Eastern Europe. The proceedings of the conference will be published by Physica Verlag, Heidelberg, in the series Studies in Empirical Economics.

Seminar on Macroeconomic Management: Managing Inflation in a Transition Period
June 24-28, Hanoi, Vietnam

Organized by the World Bank’s Economic Development Institute and the National Economics University, Hanoi, to help policymakers better understand macroeconomic policy alternatives, with special emphasis on management of inflation during transition.

The Transformation of Socialist Economies
June 26-28, Kiel, Germany

Organized by the Kiel Institute of World Economics. Focus will be on policy strategies for transition — in particular the necessary changes in institutional infrastructure — to assess ways to privatize firms and restructure economies; and timing and sequencing of privatization, macroeconomic stabilization, microeconomic deregulation, and external liberalization; the economic integration of Germany; and the policy options for the individual East European countries.

Information: Kiel Institute of World Economics, Duesternbrooker Weg 120, PO Box 4309, D-2300 Kiel 1, Germany. Tel.: 431/884-1 ext.236, fax: 431/8853.

The Changing Structure of Income and Social Policy in Eastern Europe: A Comparative Focus for LIS
July 21-23, Walferdange, Luxembourg

Four-day international conference, sponsored by the Ford Foundation, U.S. National Institute on Aging, and LIS. The Luxembourg Income Study has a unique role: to compare the economic status of households in Eastern and Western Europe, using household income data for at least 15 West European and four East European countries. The conference, for East European statistical officials and researchers and Western experts, will deal with the criteria for comparing social policies (children and family benefits, pensions, unemployment insurance, anti-poverty measures) and household welfare in the economies of transition. A separate session will focus on comparing the distribution of income in the East and West, using existing LIS datasets.
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USSR


Sorg, Mart. Reform of the Estonian financial system. UNITAS (Finland) 62: 54-59.

Eastern and Central Europe


Germany


Africa


Asia


Latin America


* For more information, contact the Joint Bank-Fund Library, 202-623-7064.